CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

February 16, 2006

H.R. 3505
Financial Services Regulatory Relief Act of 2005

As ordered reported by the House Committee on the Judiciary
on February 15, 2006

SUMMARY

H.R. 3505 would affect the operations of financial institutions and the agencies that regulate them. Some provisions would address specific sectors: national banks could more easily operate as S corporations or adopt other alternative organizational structures; thrift institutions would be given some of the same investment, lending, and ownership options available to banks; credit unions would have new options for investments, lending, mergers, and leasing federal property; and certain privately insured credit unions could become members of the Federal Home Loan Bank system. The bill would provide the Federal Deposit Insurance Corporation (FDIC) with new enforcement authority and modify regulatory procedures governing certain types of transactions. It also would give financial regulatory agencies more flexibility in sharing data, retaining records, and scheduling examinations. Finally, the bill would direct the Secretary of the Treasury to develop various reports, regulations, and programs related to currency transactions.

CBO estimates that enacting this bill would reduce federal revenues by $64 million over the 2006-2011 period and by a total of $167 million over the 2006-2016 period. In addition, we estimate that direct spending would increase by $2 million over the 2006-2011 period and by a total of $7 million over the 2006-2016 period. Provisions affecting programs funded by annual appropriations would cost another $4 million in 2007, CBO estimates, assuming appropriation of the necessary amounts.

H.R. 3505 contains intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA), but CBO estimates that the cost of complying with the requirements would be small and would not exceed the threshold established in UMRA ($64 million in 2006, adjusted annually for inflation).

H.R. 3505 contains several private-sector mandates as defined in UMRA. Those mandates would affect some depository institutions controlled by commercial firms, certain depository institutions and institution-affiliated parties, nondepository institutions that control depository institutions, uninsured banks, bank holding companies and their subsidiaries, and savings and loan association holding companies and their subsidiaries. At the same time, the bill would relax some restrictions on the operations of certain financial institutions. CBO estimates that the aggregate direct costs of complying with the private-sector mandates in the bill would not exceed the annual threshold established by UMRA ($128 million in 2006, adjusted annually for inflation).

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 3505 is shown in the following table. The costs of this legislation fall within budget function 370 (commerce and housing credit).

	By Fiscal Year, in Millions of Dollars										
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
CHANGES IN REVENUES											
Estimated Revenues[a]											
S Corporation Status	*	-6	-11	-14	-16	-13	-14	-15	-16	-17	-18
Business Organization Flexibility	0	*	*	-1	-1	-2	-2	-4	-5	-6	-6
Total	*	-6	-11	-15	-17	-15	-16	-19	-21	-23	-24
CHANGES IN DIRECT SPENDING											
Estimated Budget Authority	*	*	*	*	1	1	1	1	1	1	1
Estimated Outlays	*	*	*	*	1	1	1	1	1	1	1
CHANGES IN SUBJECT TO APPROPRIATION											
Estimated Authorization Level	0	4	0	0	0	0	0	0	0	0	0
Estimated Outlays	0	4	0	0	0	0	0	0	0	0	0

NOTE: * = Revenue loss or spending cost of less than $500,000.

a. Negative revenues indicate a reduction in revenue collections.

BASIS OF ESTIMATE

Most of the budgetary impacts of this legislation would result from three provisions: section 101, which would make it easier for national banks to convert to S corporation status or alternative organization forms; section 302, which would allow certain federal credit unions to lease federal land at no charge; and title VII, which would direct the Secretary of the Treasury to complete various studies, programs, and regulatory proceedings. For this estimate, CBO assumes that H.R. 3505 will be enacted during fiscal year 2006.

H.R. 3505 also would affect the workload at agencies that regulate financial institutions. We estimate that the net change in agency spending would not be significant. Based on information from each of the agencies, CBO estimates that the change in administrative expenses—both costs and potential savings—would average less than $500,000 a year over the next several years. Expenditures of the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the National Credit Union Administration (NCUA), and the FDIC are classified as direct spending and would be covered by fees or insurance premiums paid by the institutions they regulate. Any change in spending by the Federal Reserve would affect net revenues, while adjustments in the budgets of the Department of the Treasury, Securities and Exchange Commission (SEC), and Federal Trade Commission (FTC) would be subject to appropriation.

Revenues

CBO estimates that enacting H.R. 3505 would reduce federal tax revenues collected from national and state-chartered banks and would have an insignificant effect on civil and criminal penalties collected for violations of the bill's provisions.

S Corporation Status. Under this bill, some national banks would find it easier to convert from C corporation status to S corporation status. Section 101 would allow directors of national banks to be issued subordinated debt to satisfy the requirement that directors of a bank own qualifying shares in the bank. This provision would effectively reduce the number of shareholders of a bank by removing directors from shareholder status, making it easier for banks to comply with the 100-shareholder limit that defines eligibility for subchapter-S election.

Income earned by banks taxed as C corporations is subject to the corporate income tax, and post-tax income distributed to shareholders is taxed again at individual income-tax rates. Income earned by banks operating as S corporations is taxed only at the personal income-tax rates of the banks' shareholders and is not subject to the corporate income tax. The average effective tax rate on S-corporation income is lower than the average effective tax rate on

C-corporation income. CBO estimates that enacting this provision would reduce revenues by a total of $60 million over the 2006-2011 period and by $140 million over the 2006-2016 period.

Based on information from the Federal Reserve Board, the OCC, and private trade associations, CBO expects that most of the banks that would be affected are small, although banks and bank holding companies with assets over $500 million would also be affected. In addition, states are likely to amend the rules for state-chartered banks to match those for national banks. CBO expects that most conversions to subchapter-S status would occur between 2006 and 2008 and that national banks would convert earlier than state-chartered banks.

Business Organization Flexibility. Under section 109 of this bill, the Comptroller of the Currency could allow national banks to organize in noncorporate form, for example as Limited Liability Companies (LLCs) as defined by state law. LLCs generally choose to be taxed as partnerships. Only a few states currently allow banks to organize as LLCs, however, and the IRS currently taxes state-chartered bank-LLCs as C corporations. LLCs provide more organizational flexibility than S corporations while retaining the corporate characteristic of limited liability.

Income earned by banks taxed as C corporations is subject to the corporate income tax, and post-tax income distributed to shareholders is taxed again at individual income tax rates. Income earned by partnerships—like that earned by S corporations—is taxed only at the personal income-tax rates of the partners and is not subject to the corporate income tax. The average effective tax rate on partnerships is lower than the average effective tax rate on C-corporation income but is similar to the average effective tax rate on S-corporation income.

Based on information from the OCC, the FDIC, and private trade associations, CBO views that it is quite possible that the OCC would alter its regulations to allow national banks to organize in noncorporate form. CBO expects that, over the next decade, most states that do not currently allow banks to organize as LLCs will begin allowing them to do so out of competitiveness concerns. CBO also expects that the IRS is likely to reconsider allowing pass-through tax treatment to banks organized as LLCs and may allow such tax treatment at some point in the next decade. CBO believes that banks forming as LLCs would most likely be newly chartered institutions. Over the next decade, only a very limited number of banks would convert from C corporation or S corporation status to LLCs taxed as partnerships.

CBO estimates that enacting this provision would reduce revenues by a total of $4 million over 2006-2011 period and by $27 million over the 2006-2016 period.

Civil and Criminal Penalties. H.R. 3505 would make all depository institutions—not just insured institutions—subject to certain civil and criminal fines for violating rules regarding breach of trust, dishonesty, and certain other crimes. It also would authorize the FDIC to take enforcement action or impose civil penalties of up to $1 million a day on any individual, corporation, or other entity that falsely implies that deposits or other funds are insured by the agency. Based on information from the FDIC, CBO expects that enforcement actions would likely deter most individuals or institutions from violating rules regarding breach of trust, dishonesty, or certain other crimes. As a result, we estimate that any additional penalty collections under those provisions would not be significant.

Direct Spending

CBO estimates that enacting H.R. 3505 would increase direct spending by $2 million over the 2006-2011 period and about $7 million over the 2006-2016 period by reducing offsetting receipts collected from credit unions that lease federal facilities. Enacting the bill also could affect the cost of deposit insurance, but CBO has no basis for estimating the amount of any change.

Credit Union Leases. Section 302 would allow federal agencies to lease land to federal credit unions without charge under certain conditions. Under existing law, agencies may allocate space in federal buildings without charge if at least 95 percent of the credit union's members are or were federal employees. Some credit unions, primarily those serving military bases, have leased federal land to build a facility. Prior to 1991, leases awarded by the Department of Defense (DoD) were free of charge and for terms of up to 25 years; a statutory change enacted that year limited the term of such leases to five years and required the lessee to pay a fair market value for the property. According to DoD, about 35 credit unions have leased land since 1991 and are paying a total of about $525,000 a year to lease federal property. Those proceeds are recorded as offsetting receipts, and any spending of those payments is subject to appropriation.

CBO expects that enacting this provision would result in a loss of offsetting receipts from all credit union leases. Those lessees currently paying a fee would stop making those payments after they renew their current leases, all of which should expire within the next five years. In addition, credit unions that have long-term, no-cost leases would be able to renew them without becoming subject to the fees they otherwise would pay under current law. CBO estimates that enacting this provision would cost a total of about $2 million over the next six years and an average of about $700,000 annually after 2011.

Deposit Insurance. Several provisions in the bill could affect the cost of federal deposit insurance. For example, the bill would streamline the approval process for mergers, branching, and affiliations, which could give eligible institutions the opportunity to diversify and compete more effectively with other financial businesses. In some cases, such efficiencies could reduce the risk of insolvency. It is also possible, however, that some of the new lending and investment options could increase the risk of losses to the deposit insurance funds.

CBO has no clear basis for predicting the direction or the amount of any change in spending for insurance that could result from the new investment, lending, and operational arrangements authorized by this bill. The net budgetary impact of such changes would be negligible over time, however, because any increase or decrease in costs would be offset by adjustments in the insurance premiums paid by banks, thrifts, or credit unions.

Spending Subject to Appropriation

H.R. 3505 also would affect spending for activities funded by annual appropriations. CBO estimates implementing those provisions would cost about $4 million in 2007, assuming appropriation of the necessary amounts.

Title VII would direct the Secretary of the Treasury to develop and implement various measures related to the reporting of currency transactions. Based on information from the Treasury, CBO estimates that it would cost about $4 million to complete the regulations, reports, and programs required by the bill, assuming appropriation of the necessary amounts.

In addition, section 201 provides thrift institutions with exemptions from broker-dealer and investment-advisor registration requirements similar to those accorded banks. Section 313 provides similar exemptions for federally insured credit unions. Based on information from the SEC, CBO estimates that the budgetary effects of those exemptions would not be significant.

Finally, section 312 would exempt federally insured credit unions from filing certain acquisition or merger notices with the FTC. Under current law, the FTC charges filing fees ranging from $45,000 to $280,000, depending on the value of the transaction. The collection of such fees is contingent on appropriation action. Based on information from the FTC, CBO estimates that this exemption would have no significant effect on the amounts collected from such fees.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

H.R. 3505 contains intergovernmental mandates as defined in UMRA, because it would preempt certain state laws and place new requirements on certain state agencies that regulate financial institutions. CBO estimates that the cost of complying with the requirements would be small and would not exceed the threshold established in UMRA ($64 million in 2006, adjusted annually for inflation).

Provisions in section 209 would preempt certain state securities laws by prohibiting states from requiring agents who represent a federal savings association to register as brokers or dealers if they sell deposit products (CDs) issued by the savings association. Such a preemption would impose costs (in the form of lost revenues) on those states that currently require such registration. Based on information from representatives of the securities industry and securities regulators, CBO estimates that losses to states as a result of this prohibition would total less than $1 million a year.

Other provisions of the bill would place requirements on state regulators of credit unions to review documents related to federal deposit insurance and to provide certain information to the NCUA. Also, section 401 would extend certain preemptions of state laws related to mergers between insured depository institutions chartered in different states and preempt state laws that regulate certain fiduciary activities performed by insured banks and other depository institutions. Section 619 provides that only certain bank supervisors may impose supervisory fees on the bank. Based on information from industry authorities and state entities, CBO estimates that these provisions would impose minimal costs, if any, on state, local, and tribal governments.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

H.R. 3505 contains several private-sector mandates as defined by UMRA. At the same time, the bill would relax some restrictions on the operations of certain financial institutions. CBO estimates that the aggregate direct costs of mandates in the bill would not exceed the annual threshold established in UMRA ($128 million in 2006, adjusted annually for inflation).

Mandates in the bill include a prohibition of interstate branching by certain depository institutions controlled by commercial firms, an expansion of the authority of federal banking agencies over insured depository institutions and institution-affiliated parties with respect to safety and soundness enforcement, and restrictions on participation in the affairs of financial institutions of people convicted of certain crimes or the subject of certain criminal proceedings.

Prohibition of Interstate Branching by Subsidiaries of Commercial Firms

The bill would prohibit interstate branching by industrial loan companies or industrial banks or certain other depository institutions that are controlled by firms that derive 15 percent or more of their revenues from nonfinancial activities. The prohibition would not apply to such institutions that became insured depository institutions before October 1, 2003.

This mandate only applies to a handful of institutions, none of which currently operates any branches. While the mandate does take away their option to open branches in other states, according to government and industry sources, the affected institutions had no immediate plans to use the option to branch. Consequently, CBO estimates that there would be little or no direct cost to comply with this mandate.

Enhanced Safety and Soundness Enforcement

The bill would expand some of the authorities of federal banking agencies with respect to troubled or failing institutions, and institution-affiliated parties. Based on information from the FDIC, the cost to the private sector of these expanded authorities would be small.

The Gramm-Leach-Bliley Act allowed new forms of affiliations among depositories and other financial services firms. Consequently, insured depository institutions may now be controlled by a company other than a depository institution holding company (DIHC). The bill would amend current law to give the FDIC certain authorities concerning troubled or failing depository institutions held by those new forms of holding companies.

Cross-Guarantee Authority. Under current law, if the FDIC suffers a loss from liquidating or selling a failed depository institution, the FDIC has the authority to obtain reimbursement from any insured depository institution within the same DIHC. Section 407 would expand the scope of the FDIC's reimbursement power to include all insured depository institutions controlled by the same company, not just those controlled by the same DIHC.

The cost of this mandate would depend, among other things, on the probability of failure of the additional institutions subject to this authority and the probability that the FDIC would incur a loss as a result of those failures. The new authority would apply only to a handful of depository institutions. Based on information from the FDIC, CBO estimates that the cost of this mandate would not be substantial.

Golden Parachute Authority and Nonbank Holding Companies. Section 408 would allow the FDIC to prohibit or limit any company that controls an insured depository from making "golden parachute" payments or indemnification payments to institution-affiliated parties of troubled or failing insured depositories. (Institution-affiliated parties include directors, officers, employees, and controlling shareholders. Institution-affiliated parties also include independent contractors such as accountants or lawyers who participate in violations of the law or undertake unsound business practices that may cause a financial loss to, or adverse effect on, the insured depository institution.)

Based on information from the FDIC, CBO expects that only a few institutions would be covered by the new authority. In the event that the FDIC exercises this authority, CBO expects that the cost to institutions of withholding such payments would be administrative in nature and minimal, if any.

Restrictions on Convicted Individuals

Current law prohibits a person convicted of a crime involving dishonesty, a breach of trust, or money laundering from participating in the affairs of an insured depository institution without FDIC approval. The bill would extend that prohibition so that uninsured banks, bank holding companies and their subsidiaries, and savings and loan holding companies and their subsidiaries could not allow such persons to participate in their affairs without the prior written consent of their designated federal banking regulator.

Assuming that those institutions already screen potential directors, officers, and employees for criminal offenses, the incremental cost of complying with this mandate would be small.

PREVIOUS CBO ESTIMATE

On December 8, 2005, CBO transmitted a cost estimate for H.R. 3505 as ordered reported by the House Committee on Financial Services on November 16, 2005. The two versions of the bill are identical, but CBO updated the estimate of costs to reflect a later date of enactment and CBO's new baseline projections of corporate tax revenues.

The intergovernmental and private-sector mandates in both versions of the bill are the same.

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